

Members:

Sen. Tom Weatherwax, Chairperson  
Sen. Richard Young  
Sen. James Merritt  
Sen. Katie Wolf  
Rep. Markt Lytle  
Rep. Claire Leuck  
Rep. James Buck  
Rep. William Friend

Advisory Members:

Herschel Cook  
David Butterfield  
Barbara Haas  
Karen Large  
Howard Hatcher  
William Goffinet  
James Murphy  
Judith Anderson  
Eugene Hostettler  
Stephen Queior  
David Bennett  
Michael Claytor

LSA Staff:

Edward Gohmann, Attorney for the Commission  
David Hoppmann, Fiscal Analyst for the Commission

Authority: P.L.242-1997



## **LOCAL GOVERNMENT FINANCE STUDY COMMISSION**

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### **MEETING MINUTES**

**Meeting Date:** July 21, 1998  
**Meeting Time:** 10:00 A.M.  
**Meeting Place:** State House, 200 W. Washington St.,  
Room 431  
**Meeting City:** Indianapolis, Indiana  
**Meeting Number:** 2

**Members Present:** Sen. Thomas Weatherwax, Chairperson; Sen. James Merritt; Sen. Katie Wolf; Rep. Claire Leuck; Rep. James Buck; Rep. William Friend; David Butterfield; Karen Large; Howard Hatcher; William Goffinet; Judith Anderson.

**Members Absent:** Rep. Markt Lytle; Sen. Richard Young; Herschel Cook; David Bennett; Michael Claytor; Barbara Haas; Stephen Queior; Eugene Hostettler; James Murphy.

#### **1. Call to Order**

Senator Tom Weatherwax, the Chairman of the Commission, called the meeting to order shortly after 10:00 a.m.

#### **2. Testimony of Professor Larry DeBoer concerning the Citizens' Commission on Taxation**

Senator Weatherwax stated that he had invited Professor Larry DeBoer, who has been working as staff for the Citizens' Commission on Taxation, to give the Local

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Government Finance Study Commission an update on the work of the Citizens' Commission. Senator Weatherwax commented that he hoped the Citizens' Commission would examine the past work of the Local Government Finance Study Commission and use that work in preparing its recommendations.

Professor DeBoer explained that the Citizens' Commission intends to put together for the Governor a "briefing book" that includes a list of tax restructuring options and the costs and benefits associated with those options. He stated that the Governor had charged the Citizens' Commission with coming up with revenue-neutral proposals to reduce property taxes. Professor DeBoer noted that some members of the Citizens' Commission had proposed property tax reduction plans that did not include dollar-for-dollar replacement of any lost property tax revenue. Professor DeBoer then said that the Citizens' Commission had created a number of subcommittees to study various issues and make recommendations. He commented that the two basic issues facing the Citizens' Commission were: (1) how to reduce property taxes; and (2) what revenue would replace the lost property tax revenue.

He explained that, theoretically, property taxes could be reduced in a number of ways, such as: (1) reducing the types of government services funded by property taxes (e.g., removing welfare expenditures or school general fund expenditures from property tax funding); (2) removing some types of property -- for example, business inventory -- from the property tax base; (3) providing targeted tax relief to particular groups (e.g., providing relief to homeowners by increasing the homestead credit); or (4) providing an equal percentage reduction in all taxpayers' property tax liability.

Professor DeBoer then stated that the state sales tax and the state income tax are the only existing taxes that could raise enough revenue to replace a significant amount of property tax revenue. He noted that some persons had suggested that the Citizens' Commission should advocate restricting the growth of state and local spending and using the money that is saved to replace property tax revenue, but he then reiterated that the Governor's charge to the Citizens' Commission had been for it to make recommendations that are revenue-neutral.

Professor DeBoer then suggested that there are a number of other issues to think about when considering tax restructuring, such as: (1) the stability of the various taxes; (2) the effect that particular taxes would have on economic development; and (3) who will pay the various taxes. According to Professor DeBoer, the property tax is the most stable of Indiana's taxes, while the corporate adjusted gross income tax and the supplemental net income tax are the least stable. He noted that business pays approximately 61% of Indiana property taxes and that individuals pay the greatest shares of state sales and income taxes. He explained that if the property tax is replaced by sales and income tax revenue, there would be a shift in some of the tax burden from business onto individuals. Professor DeBoer speculated that it might be

difficult for the thirty-two members of the Citizens' Commission to agree on what is a fair share of the tax burden for business and for individuals. He also pointed out that it is important to look behind the statutory incidence of taxes (that is, who actually pays the tax) to the economic incidence of those taxes (that is, to whom are the costs ultimately passed).

Professor DeBoer next briefly described the history of the *Town of St. John* case, which involves constitutional challenges to Indiana's current "true tax value" method of property tax assessment. He explained that: (1) the plaintiffs filed their lawsuit in September of 1993; (2) the Indiana Tax Court in May of 1996 held the current method of property tax assessment unconstitutional on the grounds that the Indiana Constitution required a fair market value method of assessment; (3) the Indiana Supreme Court in December of 1996 had, after deciding that the Indiana Constitution did not require a fair market value method of assessment, overturned the Tax Court's decision and remanded the case to the Tax Court; (4) the Tax Court held in December of 1997 that although the Indiana Constitution may not require a fair market value method of assessment, the current true tax value method of assessment violates the Indiana Constitution; and (5) the Indiana Supreme Court has scheduled oral arguments in the appeal of the Tax Court's latest decision for September of this year. Professor DeBoer noted that a change in the property tax assessment system from the current true tax value method to a fair market value method would cause a large shift in the property tax burden onto homeowners. He stated that he was unsure how the *Town of St. John* case and the Citizens' Commission's work would interact, noting first that it was impossible to predict how the Indiana Supreme Court would decide that case, and second that the Court's decision could cause any consensus reached by the Citizens' Commission to fall apart.

Senator Weatherwax asked Professor DeBoer whether the Citizens' Commission would prioritize the policy options that it recommends to the Governor. Professor DeBoer responded that the Citizens' Commission might rank its recommendations to the Governor, but that it was also important for the Citizens' Commission to provide information on the options in a way that would allow the General Assembly to put together its desired mix of tax increases and tax reductions.

In response to Senator Weatherwax's question of whether the Citizens' Commission was only looking at property tax relief issues, Professor DeBoer answered that it was looking at other issues as well, such as business taxation and property tax administration.

Representative Jim Buck commented that it is difficult to come up with proposals to lower property taxes because of the uncertainty of how the *Town of St. John* case would be decided. He asked Professor DeBoer whether the Citizens' Commission intended to provide alternatives that consider various ways in which that case could be

decided. Professor DeBoer responded that he believed it would make sense to do so.<sup>1</sup>

### **3. Testimony Concerning Property Taxation of Inventory**

Senator Weatherwax then described how attempts had been made in the past to reduce the burdens from property taxes imposed on business inventory. He commented that those attempts had not been successful, but that possibly the next session of the General Assembly would be the right time to accomplish inventory tax relief. Senator Weatherwax then asked Mr. William Styring of the Hudson Institute to address the Commission concerning the inventory tax.

Mr. Styring first noted that Indiana is one of only a handful of states that impose property taxes on inventory. He stated that there is widespread agreement among economists that the inventory tax is one of the "most pernicious" taxes. Mr. Styring stated that during the 1960s many economists thought that the state and local tax structure had little effect on business location, but that recent studies with improved methodology show that considerations of state and local taxes are in fact important in business location decisions. He noted that after a decision concerning what region to locate in has been made, even small differences in state and local taxes can be important in the determination of the exact location of a new or expanding business. Mr. Styring then suggested that because of its location, Indiana would generally be considered a good place to locate distribution centers, but the fact that Indiana is one of few states to tax inventory has led to fewer distribution centers operating in Indiana than would otherwise be expected. He noted that nearby states do not tax inventories and that inventory is a very mobile factor of production.

He then stated that studies have shown that if the state were to provide a credit against 50% of the inventory taxes paid by business, within seven years the state revenue generated by increased employment and investment would more than offset the lost property tax revenue. He commented that other studies have concluded that the lost property tax revenue would be offset even sooner.

Representative Buck stated that the 1995 motor vehicle excise tax cuts had led to an increase of over 3,300 jobs in Indiana. He asked Mr. Styring whether there was any information concerning the economic development impact of additional motor vehicle excise tax cuts. Mr. Styring said that it was difficult to provide an exact figure. He suggested that the overall changes in economic activity could be estimated and from

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<sup>1</sup>Copies of Professor DeBoer's presentation to the Local Government Finance Study Commission ("Issues for Tax Restructuring", "Issues for Indiana Tax Reform", and "Fiscal Options") are on file in the Legislative Information Center, Room 230, State House, Indianapolis, Indiana 46204. The telephone number of the Legislative Information Center is (317) 232-9856, and the mailing address is 200 W. Washington St., Suite 301, Indianapolis, Indiana 46204-2789.

this estimate the number of additional jobs could be extrapolated.

Senator Weatherwax commented that one element of determining fairness in taxation is to examine how Indiana's tax structure relates to what other states are doing. Senator Weatherwax also noted that ultimately the costs of all taxes are paid by people. Representative Buck asked Mr. Styring how many jobs or opportunities for new jobs have been lost because of the inventory tax. Mr. Styring answered that probably tens of thousands, possibly even hundreds of thousands of jobs or job-creation opportunities have been lost. He stated that it is difficult to get businesses to explain exactly why they choose to relocate or not add new jobs.<sup>2</sup>

Senator Weatherwax then asked Mr. Ed Bowman, Indiana Director of the National Federation of Independent Business (NFIB), to address the Commission concerning the inventory tax. Mr. Bowman began by noting that he had spent the last thirty years arguing for a repeal of the inventory tax and trying to educate the citizens of Indiana on what he considered to be its negative effects on job creation and capital development. He then stated that in the 1960s Indiana had done one of the first major studies of the problems associated with the inventory tax. He commented that when the study was done, only twelve states had taken any action to reduce or eliminate inventory taxes, but that now, thirty years later, Indiana is one of only eleven states that have not taken such action.

Mr. Bowman stated that he believes the inventory tax should be repealed because it is "inequitable, discriminatory, unsound, and countercyclical." He asserted that although it is difficult to quantify the negative effects that the inventory tax has on employment growth and investment, its impairment of economic development can nonetheless be shown through anecdotal evidence. He said that the inventory tax is especially hard on small business, and he stated that the NFIB's annual surveys of Indiana small businesses show that they regard it as their biggest problem. He explained that larger corporations may dislike the potential revenue replacement options more than they dislike the inventory tax, and he suggested that this lack of consensus in the business community may have in the past been an obstacle to repealing the inventory tax.

Mr. Bowman stated that it is widely believed that approximately 85% of job growth comes from existing business and that the majority of this growth is attributable to small business. He commended the General Assembly on the incentives they had enacted and the actions they had taken to encourage job creation in Indiana, but he stated that by not taking any action to reduce or repeal the inventory tax the General Assembly had left in place the biggest obstacle to economic development. He also stated that the Uniformity Clause of the Indiana Constitution would most likely have to

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<sup>2</sup>Copies of Mr. Styring's written material ("Property Taxes on Indiana's Inventories") are on file in the Legislative Information Center. See footnote 1.

be amended before the inventory tax could be repealed outright.

Representative Buck asked Mr. Bowman whether he thought that during the past thirty years the issues surrounding the inventory tax had been so politicized that it was difficult for the General Assembly to act responsibly. Representative Buck stated that he could see no other reason why the General Assembly had failed to enact some form of inventory tax relief. Mr. Bowman answered that the problems that had prevented progress on inventory tax relief were the difficulty in finding replacement revenue, the potential constitutional issues, and the lack of understanding of the issues involved. He commented that the last problem had led to politicization of the issue.

Representative Bill Friend commented that the inventory tax is an unfair tax on agriculture. He stated that individual agricultural producers have enough difficulty finding any competitive advantages, without facing the added burden of the inventory tax. Mr. Bowman noted that the Indiana Farm Bureau had strongly supported inventory tax relief. Representative Claire Leuck agreed with Representative Friend's comments concerning the difficulties faced by farmers, noting that producers of commodities could not pass on the cost of the tax. She also pointed out that the tax is not tied to profitability of farmers or other businesses. Senator Katie Wolf commented that some reports or studies list Indiana as a relatively low tax state, but she stated that the mix of taxes is not necessarily equitable. Mayor David Butterfield commented that the Citizens' Commission had heard testimony concerning potential tax shifts and the members realized they would have to recommend an option to lower those shifts.<sup>3</sup>

#### **4. Next Meeting Date; Adjournment**

After thanking the Commission members and witnesses for their attendance at the meeting, Senator Weatherwax stated that the Commission's next meeting would be held on September 15, 1998, at 10:00 a.m. in Room 431 of the State House. Senator Weatherwax then adjourned the Commission meeting.

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<sup>3</sup>Copies of material presented by Mr. Bowman to the Local Government Finance Study Commission are on file in the Legislative Information Center. Copies of material presented to the Commission by staff ("Summary of Proposed Inventory Tax Legislation", "Estimated Inventory Tax Levy Share of Total Net Levy, by County", and "Estimated Net Inventory Tax Levy, by Taxing District and Levy Amount") are also on file in the Legislative Information Center. See footnote 1.